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WEALTH MANAGEMENT
Integrity. Independence. Insight.

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"If economists wished to study a horse, they wouldn't go and look at horses. They'd sit in their studies and say to themselves, 'What would I do if I were a horse?'" – Ely Devons, English economist

Dear Fellow Investor:

Well, 2017 is in the books and it did not turn out as many "experts" had predicted and, as investors, most of us are pleased with the outcome. The equity markets generally maintained their steady march upward in the 4th quarter of 2017 with a continuation of declining volatility. Economic growth synchronized across the globe with 61% of world economies experiencing above long-term trend growth levels (reported by Oppenheimer). The US economic recovery passed the 100 month mark, corporate earnings improved and inflation remained in check. The results for the year were an S&P 500 index up 21.8% and that was beaten by both international developed markets (MSCI EAFE) and emerging markets (MSCI EME). These results came in a year with unprecedented low volatility across markets. None of the major asset classes had a negative return for the year (data from JP Morgan Asset Management). While we would all like every year to look like 2017, we know they won't, and we need to keep that in focus as we move into 2018.

There were many predictions going into 2017, but we don't recall any that matched actual performance. Of course, that is not unusual given the track record of economic forecasting. The maturity of the economic expansion in the US and the anticipated political turmoil led many prognosticators to hedge their forecasts or just be pessimistic.

We go into 2018 with a favorable environment. US economic growth is improving and the new tax law is widely anticipated to be a positive factor going forward. Consumer confidence is solid and the employment rate continues to creep lower, although improvements from the current level will be increasingly difficult as we reach unemployment levels not seen in nearly 20 years. Wage growth, which has been sluggish to non-existent during the recovery so far, is starting to improve as the labor market tightens. This and expected lower taxes should be economic pluses, combining to improve the finances of consumers.

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As the labor market continues to tighten, capital investment will be more critical to maintain productivity improvements. GDP growth is a combination of labor growth and productivity improvements. If the former slows then the latter needs to make up the slack. The new tax law features lower corporate tax rates and faster expensing of capital investments both of which should make productivity improving investments more attractive. A general positive business environment with less uncertainty should also continue to encourage things along.

We are not without our concerns, of course. The performance of the equity markets has left valuations at above average levels. The question is always how high is too high and are there factors that can justify these valuations, such as future earnings and lower taxes? The Federal Reserve is really at the beginning of reducing its balance sheet, which was bloated from the liquidity injected after the 2008 financial crisis. This balance sheet reduction is unprecedented and uncharted territory for the Fed and the economy. The Fed's efforts will be followed by similar actions by other central banks, collectively pulling out a considerable amount of liquidity from the global economy. Will these actions lead to higher interest rates and at what point will that have a negative effect on growth? Will the job market tighten to the point of creating a growth constraint? Will wage growth accelerate and combine with higher interest rates to make inflation a factor again? We can go on. We can always go on, but that is really the point. The global economy is a massive collection of moving parts, individual decisions, unexpected occurrences and luck, both good and bad.

So where should we focus our attention going into 2018? First and foremost is to not expect it to be like 2017. In the end it may, but history tells us that is very unlikely. Will equity markets be higher of lower? The answer is a definite "yes". We just don't know. Look back a year and ask yourself how much of the solid performance of 2017 was generally unanticipated. Taking a short-term view in very human, but also tends to be very harmful. We cannot emphasize enough the self-destructive actions that must be continually avoided for long-term investment success. It is particularly salient after a year like 2017 when everything seems to be hitting on all cylinders. Equity performance likely left many portfolios unbalanced relative to their long-term objectives. The natural response is to look at the most recent year and expect a continuation, i.e. chasing winners. The average return on the S&P 500 since 1988 has been 12.2%, but the average absolute year to year change over that time period has been 18.7% (data from Y-Charts). The hard thing to do is rebalance by reducing the winners and moving assets into those that did not perform as well in 2017. History can teach us many lessons, but the most valuable ones may be how difficult it is to predict what is to come and the penalty for complacency. It can be humbling, and doubly so when it involves your money.

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So, as we look ahead to the new year and all the changes and excitement it may bring, let's not dwell too much on the immediate past, but put it in the context of a longer term perspective. We live in a time of great change and we have the good fortune as investors to benefit from that change, but how you participate should be unique to you and your needs. It is important to not let recent events or performance cloud our long-term approach. As they say, "past performance is no guarantee of future results". That is as important to remember after a year like 2017 as it was after 2008. Happy New Year and may we all prosper in 2018.

Sincerely,

Erik G. Ford
Director of Wealth Management

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The Standard and Poor's 500 (S&P 500) Index is a capitalization weighted index of 500 stocks designed to measure performance of the domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. You cannot directly invest in the index.

The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries* around the world, excluding the US and Canada. With 928 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. You cannot directly invest in the index.

The MSCI EME (Emerging Markets) Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries*. With 846 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. You cannot directly invest in the index

The VIX is quoted in percentage points and represents the expected range of movement in the S&P 500 index over the next year, at a 68% confidence level (i.e. one standard deviation of the normal probability curve). For example, if the VIX is 15, this represents an expected annualized change, with a 68% probability, of less than 15% up or down.

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Any economic forecasts set forth in the above may not develop as predicted and there can be no guarantee that strategies promoted will be successful. Past performance is no guarantee of future results.